# Keysight Technologies Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO W-01(A)272–05 OF 2021
KAMALUDIN MD SAID, ABU BAKAR JAIS AND COLLIN SEQUERAH JJCA
12 JUNE 2024

*Revenue Law — Income tax — Assessment — Respondent issued notice of additional assessment on appellant in respect of disposal of technical know-how ('IP rights') — Whether appellant's receipt from disposal of IP rights was income in nature — Whether respondent's additional assessment was time barred — Whether respondent had discharged its burden in proving that appellant was negligent in lifting time-bar — Whether respondent correct in imposing penalties at rate of 45% against appellant*

The appellant operated as a full-fledged manufacturer of various microwave devices, test accessories, amplifiers and transceivers. In the course of its operations as a full-fledged manufacturer, the appellant developed technical know-how in manufacturing and marketing activities ('IP rights'). Following a restructuring, the appellant converted from a full-fledged manufacturer into a contract manufacturer for Agilent Technologies International S.a.r.l ('ATIS') on 1 March 2008. ATIS was the principal factory of the Agilent Technologies Group located in Switzerland. The appellant sold its IP rights to ATIS by way of an intellectual property transfer agreement ('the IP transfer agreement') for RM821,615,000. After the sale of the IP rights, by way of a manufacturing services agreement ('the manufacturing services agreement'), ATIS granted the appellant a licence to use the IP rights for the sole and exclusive purpose of contract manufacturing for ATIS. The appellant no longer produced and sold its own products, no longer owned the materials, the IP rights and inventory and did not derive profit from the selling of the manufactured goods. Instead, the appellant provided manufacturing services for products which belonged to ATIS, with raw materials supplied by ATIS and was a licensee of the IP rights. The appellant was compensated on a cost-plus basis for the contract manufacturing services provided. On 31 October 2008, the appellant filed its tax returns and computations for year assessment ('YA 2008') with the respondent. The appellant reported the receipt from the sale of IP rights of RM821,615,000 as a gain which was capital in nature, and hence not taxable. On 9 March 2017, the respondent contended that the income received by the appellant for the sale of the IP rights was income in nature and therefore subject to income tax under s 4(f) of the Income Tax Act 1967 ('ITA'). The respondent alleged that the appellant was negligent for 'failing to report this income.' On

A 13 June 2017, the respondent issued its notice of additional assessment for YA 2008, imposing additional tax and 45% penalty on the appellant amounting to RM311,057,602.46 ('the assessment'). The appellant disputed the assessment and appealed to the Special Commissioners of Income Tax ('SCIT'). The SCIT dismissed the appeal and the appellant then appealed against the decision of the B SCIT to the High Court ('HC') which appeal was dismissed. The SCIT and the HC found that: (a) the badges of trade test, which was applied to distinguish between capital and income, was only applicable to cases involving acquisition of property or land and did not apply to cases involving a disposal of intellectual property rights; (b) the receipt from the sale of IP rights was C income in nature as there was no 'outright sale' of the IP rights because it was only beneficial rights to the IP rights that were transferred; (c) there was no evidence of registration of legal title of the IP rights in the name of ATIS as the appellant was still using the IP rights in the manufacturing of the same products after the sale; (d) there was no evidence that the IP rights referred to D in the manufacturing services agreement and IP transfer agreement were the same as the receipt represented payment for the appellant's loss of income, based on the valuation method used in the valuation report; (e) the assessment was not time-barred as the appellant was negligent in failing to report the receipt from the sale of IP rights as income in its tax returns and failing to E furnish the valuation report during the course of the audit; (f) the appellant was negligent in failing to prove that there was an 'outright sale' of the IP rights; and (g) the respondent had correctly imposed 45% penalties on the appellant under s 113(2) of the ITA. Hence, this appeal.

F **Held**, allowing the appeal:

(1) The badges of trade test was not merely confined to the receipt or disposal of land or property and thus was the proper test to be applied in the present case. The operative words of the Act and s 4 of the ITA dealt G with tax on 'income' and it could not be lumped into an all or sundry provision as suggested by the respondent. Both the SCIT and the HC had therefore erred in holding that the badges of trade test was inapplicable. It was evident that the receipt from the sale was not income in nature as the appellant was not in the business of selling intellectual H property rights, but of manufacturing testing devices for electronic appliances. The disposal of the IP rights was a disposal of a capital asset and the receipt from the sale of such capital asset constituted a capital receipt, which was not income in nature and therefore not taxable (see paras 49, 50, 59–61 & 73).

I (2) The respondent's contention that there was no proof of an outright sale of the IP rights because the IP transfer agreement and the manufacturing services agreement did not show any evidence that legal rights (title) had been transferred to ATI and ATIS did not hold water because it was not borne out by the operative clauses in the respective agreements that

showed that there had been an actual sale of the IP rights to ATIS in exchange for consideration. There was no 'legal title' under the IP rights which could be legally transferred from the appellant to ATIS. The argument by the respondent that there must be a transfer of legal rights to evidence ownership of the IP rights was devoid of merit. Next, nowhere did the agreements provide for the situation where the ownership of the IP rights would revert to the appellant on the happening or the non-happening of a particular event. There was therefore no evidence of any reversionary rights in the appellant as contended for. The SCIT and the HC had therefore fallen into error when they applied the outright sale test and in then determining that there was no outright sale (see paras 74–75, 83, 99, 110 & 117).

(3) The HC and SCIT's finding that there was no 'outright sale' was inconsistent with their finding that the receipt represented payment for the appellant's loss of income and therefore 'outright sale' test was not the proper test to be used in distinguishing between the capital or income nature of a receipt. As the IP rights were utilised as a tool or apparatus or means through which the appellant performed its function as a full-fledged manufacturer, the drop in the appellant's profit margin after the change of its role to contract manufacturer proved that in fact there was an actual disposal of the IP rights as a capital asset. The appellant was compensated on a lesser basis as the appellant was only a licensee of the IP rights. Both the SCIT and the HC failed to consider the fact that the appellant required a license to continue using the IP rights was evidence that it no longer retained any form of ownership over the IP rights. Lastly, in the absence of invoking the anti-avoidance provisions under ss 140 and 140A of the ITA, the respondent had no basis to now contend that there was in fact no actual sale much less contend that the receipts were income in nature (see paras 123, 126–127, 129, 136 & 151).

(4) At no time did the respondent request for the valuation report during the audit phase and there was therefore no failure to produce the valuation report as alleged. The appellant could not be said to have been negligent within the meaning of s 91(3) of the ITA. Since the respondent did not raise the reason for the negligence being the failure to produce the valuation report at the time of issuing the time-barred assessment, they cold not rely on it to raise it as a reason for lifting the time bar. Next, it was difficult to see how the appellant's act of declaring the receipt from sale of IP rights as 'other income' in its income tax returns for YA 2008 to be a negligent act. The lifting of the time bar by the respondent therefore were unjustified. The SCIT and the HC had erred by misdirecting themselves accordingly (see paras 166–167, 172, 176 & 187–189).

(5) The answer to the question of whether the respondent was correct in imposing penalties against the appellant had to be in the negative in light of the earlier findings (see para 190).

**[Bahasa Malaysia summary**

Perayu beroperasi sebagai pengilang sepenuhnya bagi pelbagai peranti gelombang mikro, aksesori ujian, penguat, dan pemancar-penerima. Dalam operasi sebagai pengilang sepenuhnya, perayu membangunkan pengetahuan teknikal dalam aktiviti pembuatan dan pemasaran ('hak IP'). Selepas penstrukturan semula, perayu telah ditukar daripada pengilang sepenuhnya kepada pengilang kontrak untuk Agilent Technologies International S.a.r.l ('ATIS') pada 1 Mac 2008. ATIS adalah kilang utama Agilent Technologies Group yang terletak di Switzerland. Perayu menjual hak IPnya kepada ATIS melalui perjanjian pemindahan harta intelek ('perjanjian pemindahan IP') dengan harga RM821,615,000. Selepas penjualan hak IP, melalui satu perjanjian perkhidmatan pengilangan ('perjanjian perkhidmatan pengilangan'), ATIS memberikan perayu lesen untuk menggunakan hak IP semata-mata untuk tujuan pembuatan kontrak bagi ATIS. Perayu tidak lagi menghasilkan dan menjual produknya sendiri, tidak lagi memiliki bahan, hak IP, dan inventori serta tidak memperoleh keuntungan dari penjualan barang yang dihasilkan. Sebaliknya, perayu menyediakan perkhidmatan pembuatan untuk produk milik ATIS, dengan bahan mentah yang dibekalkan oleh ATIS dan adalah pemegang lesen hak IP. Perayu diberi pampasan berdasarkan kos tambah untuk perkhidmatan pembuatan kontrak yang diberikan. Pada 31 Oktober 2008, perayu mengemukakan penyata cukai dan pengiraan untuk tahun taksiran ('TT 2008') kepada responden. Perayu melaporkan penerimaan daripada penjualan hak IP sebanyak RM821,615,000 sebagai keuntungan bersifat modal, dan oleh itu tidak boleh dikenakan cukai. Pada 9 Mac 2017, responden mendakwa bahawa pendapatan yang diterima perayu daripada penjualan hak IP adalah bersifat pendapatan dan oleh itu tertakluk kepada cukai pendapatan di bawah s 4(f) Akta Cukai Pendapatan 1967 ('ACP'). Responden mendakwa bahawa perayu cuai kerana 'gagal melaporkan pendapatan ini.' Pada 13 Jun 2017, responden mengeluarkan notis taksiran tambahan untuk TT 2008, mengenakan cukai tambahan dan penalti 45% kepada perayu berjumlah RM311,057,602.46 ('taksiran'). Perayu membantah taksiran itu dan merayu kepada Pesuruhjaya Khas Cukai Pendapatan ('PKCP'). PKCP menolak rayuan dan perayu kemudian merayu terhadap keputusan PKCP ke Mahkamah Tinggi ('MT') yang mana rayuan itu ditolak. PKCP dan MT mendapati bahawa: (a) ujian badges of trade, yang digunakan untuk membezakan antara modal dan pendapatan, hanya terpakai untuk kes-kes yang melibatkan pemerolehan harta tanah dan tidak terpakai untuk kes yang melibatkan pelupusan hak harta intelek; (b) penerimaan daripada penjualan hak IP adalah bersifat pendapatan kerana tiada 'jualan langsung' hak IP kerana ia hanya hak berfaedah kepada hak IP yang dipindahkan; (c) tiada keterangan pendaftaran hak milik sah hak IP atas nama ATIS kerana perayu

masih menggunakan hak IP dalam pembuatan produk yang sama selepas penjualan; (d) tiada keterangan bahawa hak IP yang dirujuk dalam perjanjian perkhidmatan pengilangan dan perjanjian pemindahan IP adalah sama seperti penerimaan yang mewakili pembayaran bagi kehilangan pendapatan perayu, berdasarkan kaedah penilaian yang digunakan dalam laporan penilaian; (e) taksiran itu tidak disekat had masa kerana perayu cuai dalam gagal melaporkan penerimaan daripada penjualan hak IP sebagai pendapatan dalam penyata cukainya dan gagal mengemukakan laporan penilaian semasa audit; (f) perayu cuai dalam gagal membuktikan bahawa terdapat 'jualan langsung' hak IP; dan (g) responden telah betul mengenakan penalti 45% kepada perayu di bawah s 113(2) ITA. Oleh itu, rayuan ini.

**Diputuskan**, membenarkan rayuan:

(1) Ujian badges of trade tidak hanya terbatas kepada penerimaan atau pelupusan tanah atau harta dan dengan itu adalah ujian yang patut digunakan dalam kes ini. Perkataan berkuatkuasa Akta dan s 4 ACP berurusan dengan cukai ke atas 'pendapatan' dan ia tidak boleh disamakan dengan sebarang atau semua peruntukan seperti yang dicadangkan oleh responden. Oleh itu, PKCP dan MT telah terkhilaf apabila menyatakan bahawa ujian badges of trade tidak terpakai. Jelas bahawa penerimaan daripada penjualan tersebut bukan bersifat pendapatan kerana perayu bukan dalam perniagaan menjual hak harta intelek, tetapi dalam perniagaan pengilangan peranti ujian untuk peralatan elektronik. Pelupusan hak IP adalah pelupusan aset modal dan penerimaan daripada penjualan aset modal itu adalah penerimaan modal, yang bukan bersifat pendapatan dan oleh itu tidak boleh dikenakan cukai (lihat perenggan 49, 50, 59–61 & 73).

(2) Dakwaan responden bahawa tiada bukti penjualan langsung hak IP kerana perjanjian pemindahan IP dan perjanjian perkhidmatan pengilangan tidak menunjukkan keterangan bahawa hak undang-undang (hak milik) telah dipindahkan kepada ATI dan ATIS tidak dapat diterima kerana tidak ditanggung oleh klausa operasi dalam perjanjian-perjanjian tersebut yang menunjukkan bahawa terdapat penjualan sebenar hak IP kepada ATIS sebagai balasan kepada pertimbangan. Tiada 'hak milik sah' di bawah hak IP yang boleh dipindahkan secara sah dari perayu kepada ATIS. Hujahan oleh responden bahawa mesti ada pemindahan hak undang-undang untuk membuktikan milikan hak IP adalah tidak berasas. Seterusnya, tiada dalam perjanjian-perjanjian tersebut menyediakan untuk situasi di mana milikan hak IP akan kembali kepada perayu apabila berlaku atau tidak berlaku sesuatu peristiwa tertentu. Oleh itu, tiada keterangan hak pemulangan kepada perayu seperti yang dipertikaikan. PKCP dan MT oleh itu telah melakukan kesilapan apabila mereka memakai ujian

penjualan langsung dan kemudiannya menentukan bahawa tiada penjualan langsung (lihat perenggan 74–75, 83, 99, 110 & 117).

(3) Penemuan MT dan PKCP bahawa tiada 'penjualan langsung' adalah tidak konsisten dengan penemuan mereka bahawa penerimaan tersebut mewakili pembayaran untuk kehilangan pendapatan perayu dan oleh itu ujian 'penjualan langsung' bukanlah ujian yang wajar digunakan untuk membezakan antara sifat modal atau pendapatan sesuatu penerimaan. Oleh kerana hak IP digunakan sebagai alat atau cara di mana perayu melaksanakan fungsinya sebagai pengilang sepenuhnya, penurunan margin keuntungan perayu selepas perubahan peranannya kepada pengilang kontrak membuktikan bahawa sebenarnya ada pelupusan sebenar hak IP sebagai aset modal. Perayu diberi pampasan pada asas yang lebih rendah kerana perayu hanya sebagai pemegang lesen hak IP. Kedua-dua PKCP dan MT gagal mempertimbangkan hakikat bahawa perayu memerlukan lesen untuk terus menggunakan hak IP adalah keterangan bahawa ia tidak lagi mengekalkan sebarang bentuk pemilikan ke atas hak IP. Akhirnya, tanpa penggunaan peruntukan anti-pengelakan di bawah ss 140 dan 140A ACP, responden tidak mempunyai asas untuk menegaskan bahawa sebenarnya tiada penjualan sebenar apatah lagi menegaskan bahawa penerimaan tersebut adalah bersifat pendapatan (lihat perenggan 123, 126–127, 129, 136 & 151).

(4) Tidak pernah ada permintaan daripada responden untuk laporan penilaian semasa fasa audit dan oleh itu tidak ada kegagalan untuk mengemukakan laporan penilaian seperti yang didakwa. Perayu tidak boleh dikatakan cuai dalam erti s 91(3) ACP. Memandangkan responden tidak membangkitkan sebab kecuaian kerana kegagalan mengemukakan laporan penilaian pada masa mengeluarkan penilaian yang telah melepasi had masa, mereka tidak boleh bergantung padanya untuk membangkitkannya sebagai alasan untuk mengetepikan had masa. Seterusnya, sukar untuk melihat bagaimana tindakan perayu yang mengisytiharkan penerimaan daripada penjualan hak IP sebagai 'pendapatan lain' dalam penyata cukai pendapatannya untuk TT 2008 sebagai tindakan cuai. Penghapusan had masa oleh responden oleh itu tidak wajar. PKCP dan MT telah terkhilaf dengan menyalaharahkan secara tidak betul (lihat perenggan 166–167, 172, 176 & 187–189).

(5) Jawapan kepada persoalan sama ada responden betul dalam mengenakan penalti terhadap perayu adalah negatif berdasarkan penemuan terlebih dahulu (lihat perenggan 190).]

**Cases referred to**

*Beverly Tower Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [2022] MLJU 1873, HC (refd)

*Beynon & Co Ltd v Ogg (Surveyor of Taxes)* (1918) 7 TC 125 (refd)
*Californian Copper Syndicate (Limited and reduced) v Harris (Surveyor of Taxes)* (1904) 5 TC 159 (refd)
*Chong Woo Yit v Government of Malaysia* [1989] 1 MLJ 473, SC (refd)
*Comptroller of Income Tax v BBO* [2014] 2 SLR 609, CA (refd)
*Director-General of Inland Revenue v Hypergrowth Sdn Bhd* [2008] 1 MLJ 417, HC (refd)
*Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14, HL (refd)
*Infra Quest Sdn Bhd lwn Ketua Pengarah Hasil Dalam Negeri* [2016] 8 MLJ 680, HC (refd)
*InQpharm v KPHDN* (W-01 (A)-151–03/2021) (refd)
*Inland Revenue v Fraser* 1942 SC 493 (refd)
*Jones v Leeming* [1930] All ER Rep 584, HL (refd)
*Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn Bhd and another appeal* [2006] 3 MLJ 597, CA (refd)
*Ketua Pengarah Hasil Dalam Negeri v Procter & Gamble (Malaysia) Sdn Bhd* [2022] MLJU 743; [2022] 1 LNS 754, HC (refd)
*Martin v Lowry (Inspector of Taxes)* [1927] AC 312, HL (refd)
*NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 (refd)
*Rutledge v IRC* (1929) SC 379 (refd)
*Sekong Rubber Co Ltd v Director-General of Inland Revenue* [1980] 2 MLJ 198 (refd)

**Legislation referred to**

Income Tax Act 1967 ss 1, 4, 4(a), (f), 91(1), (3), 113(2), 140, 140A

*Cyrus Das V Das (with Jason Liang Dinghui, Kellie Allison Yap Siu Yin, Jeff Sum Wai Loon and Yeoh Yao Huang) (Wong & Partners) for the appellant.*
*Hazlina bt Hussain (with Mohammad Hafidz bin Ahmad, Normareza bt Mat Rejab, Syazana Syafiah bt Roslan, Athari Faris Ammerry bin Hussein and Ashrina Ramzan Ali) (Inland Revenue Board of Malaysia) for the respondent.*

**Collin Sequerah JCA:**

INTRODUCTION

**[1]** The appellant's appeal is against the decision of the learned High Court judge ('HCJ') delivered on 6 May 2020.

**[2]** The respondent is the Director General of Inland Revenue ('the Revenue'), who had assessed the appellant to tax in the sum of RM311,057,602.46 for the year of assessment ('YA') 2008 under the Income Tax Act 1967 ('the ITA 1967').

**[3]** The appellant disputed the assessment raised by the Revenue and had

A appealed to the Special Commissioners of Income Tax ('SCIT'). The said appeal was dismissed by the SCIT on 12 March 2020.

**[4]** The appellant then appealed against the decision of the SCIT to the High Court ('HC') which appeal was dismissed. Hence, the appeal to this court.

B

CHRONOLOGY OF EVENTS

**[5]** The appellant had since its inception and for some years now operated as a full-fledged manufacturer of various microwave devices, test accessories, amplifiers and transceivers. The appellant sold its manufactured products to customers in various fields of industrial research, technology and other industries.

C

D

**[6]** In the course of its operations as a full-fledged manufacturer, the appellant developed technical know-how in manufacturing and marketing activities ('IP rights').

E **[7]** Following a restructuring, the appellant, on 1 March 2008, converted from a full-fledged manufacturer into a contract manufacturer for Agilent Technologies International S.a.r.l ('ATIS').

F **[8]** ATIS is the principal factory of the Agilent Technologies Group (to which the appellant belonged to) located in Switzerland.

**[9]** The appellant's audited financial statement for year ending 31 October 2008 under the heading 'principal activities' reflects the conversion of the appellant to a contract manufacturer.

G

**[10]** To effect its conversion to a contract manufacturer, the appellant sold its IP rights to ATIS by way of an intellectual property transfer agreement dated 1 March 2008 ('IP transfer agreement') for RM 821,615,000.

H

**[11]** After the sale of the IP rights, by way of a manufacturing services agreement dated 1 March 2008 ('manufacturing services agreement') between the appellant and ATIS, ATIS granted the appellant a licence to use the IP rights for the sole and exclusive purpose of contract manufacturing for ATIS.

I

**[12]** Post-conversion the appellant no longer produces and sell its own products, no longer owns the materials, the IP rights and inventory and does not derive profit from the selling of the manufactured goods.

**[13]** Instead, the appellant provides manufacturing services for products which belong to ATIS, with raw materials supplied by ATIS and is a licensee of the IP rights.

**[14]** In exchange for the contract manufacturing services provided, the appellant is compensated on a cost-plus basis.

**[15]** On 31 October 2008, the appellant filed its tax returns and computations for year assessment ('YA 2008') with the respondent. The appellant reported the receipt from the sale of IP rights of RM 821,615,000 as a gain which is capital in nature, and hence not taxable.

**[16]** On 30 August 2013, the respondent initiated a transfer pricing audit on the appellant. On 9 March 2017, more than nine years after the sale of the IP rights and some four years after the commencement of the audit, the respondent found no transfer pricing issues, but contended that the income received by the appellant for the sale of the IP rights was income in nature and therefore subject to income tax under s 4(f) of the Income Tax Act 1967 ('the ITA').

**[17]** The respondent alleged that the appellant was negligent for 'failing to report this income'.

**[18]** Subsequently, on 13 June 2017, the respondent issued its notice of additional assessment for YA 2008, imposing additional tax and 45% penalty on the appellant amounting to RM 311,057,602.46 ('assessment').

**[19]** It is not in dispute that the assessment was issued beyond the five year time bar period provided for under s 91(1) of the ITA.

**[20]** The appellant subsequently filed a notice of appeal to the SCIT against the notice of additional assessment on 10 July 2017 and subsequently filed an appeal to the High Court.

FINDINGS OF SPECIAL COMMISIONERS OF INCOME TAX ('SCIT') AND HIGH COURT ('HC')

**[21]** Both the SCIT and the HC found that the badges of trade test, which is applied to distinguish between capital and income, is only applicable to cases involving acquisition of property or land and does not apply to cases involving a disposal of intellectual property rights.

**[22]** They also found that the receipt from the sale of IP rights was income

A in nature as there was no 'outright sale' of the IP rights because it was only beneficial rights to the IP rights that were transferred.

**[23]** Both the SCIT and the HC found there was no evidence of registration of legal title of the IP rights in the name of ATIS as the appellant was still using the IP rights in the manufacturing of the same products after the sale.

**[24]** The SCIT and the HC also found that there is no evidence that the IP rights referred to in the manufacturing services agreement and IP transfer agreement are the same as the receipt represents payment for the appellant's loss of income, based on the valuation method used in the valuation report.

**[25]** The SCIT and the HC also found that the assessment is not time-barred as the appellant was negligent in failing to report the receipt from the sale of IP rights as income in its tax returns and failing to furnish the valuation report dated 11 March 2008 prepared by Horst Frisch ('valuation report') during the course of the audit.

**[26]** They also found that the appellant was negligent in failing to prove that there was an 'outright sale' of the IP rights.

**[27]** The SCIT and the HC finally found that the respondent had correctly imposed 45% penalties on the appellant under s 113(2) of the ITA.

PARTIES POSITIONS

**[28]** Both parties submissions and contentions are summarised herein below.

**[29]** The contention of the respondent is that the receipt of the gains from the sale of the IP rights ought to be classified as income and therefore taxable while the appellant took the position that it constitutes a sale of a capital asset and therefore not subject to tax.

**[30]** The appellant submitted that the respondent's assessment was time barred under s 91(1) of the ITA as it was raised some nine years after year of assessment ('YA') 2008.

**[31]** The respondent contended however that it was justified in lifting the time bar due to the negligence of the appellant pursuant to s 91(3) of the ITA.

**[32]** The allegations of negligence relied upon by the respondent in this regard was the appellant's failure to report the income receipt from the sale of

the IP rights, the appellant's failure to produce the valuation report during the audit stage, the appellant's failure to prove that the transfer of the IP rights was an 'outright sale' and the appellant declaring the receipt from the sale of the IP rights as 'other income' under business source 1 — manufacturing business.

**[33]** The appellant on the other hand, submitted that they had in fact reported the receipt in its tax returns as capital in nature after taking professional advice and correctly reported the gain as being in the nature of 'other income'.

**[34]** The appellant also submitted that the respondent had never requested for the valuation report during the audit stage and so is raising the issue as an afterthought.

**[35]** With regard to the respondent's allegation that the appellant failed to prove that the transfer of the IP rights was an 'outright sale', the appellant submitted that they did not owe such a duty. They further submitted that the proposition of an 'outright sale' was not supported by any legal authority.

**[36]** The appellant submitted to the contrary that the 'badges of trade' test was the proper test to be used in classifying whether a receipt was capital or income.

**[37]** Finally, the respondent submitted that the imposition of penalties of 45% pursuant to s 113(2) of the ITA upon the appellant under the circumstances was justified while the appellant contended otherwise.

ANALYSIS AND DECISION

**[38]** It is evident that this case revolves around three core issues as follows:

(a) capital or income? — whether the High Court and SCIT were correct in holding that the appellant's receipt from the disposal of IP rights, without conducting the badges of trade test, is income in nature?

(b) time bar and negligence — whether the respondent's additional assessment for YA 2008 is time barred, and whether the respondent had discharged its burden in proving that the appellant was negligent in lifting the time-bar?

(c) penalties — whether the respondent was correct in imposing penalties at the rate of 45% under s 113(2) of the Income Tax Act 1967 ('the ITA') against the appellant?

**[39]** These issues will be considered in that order.

*(A) Capital or Income?*

**[40]** The respondent took the position that the 'badges of trade' test is only applicable to matters involving the acquisition of land. As this was a case involving the disposition of intellectual property rights, the badges of trade test is inapplicable.

Badges of trade test

**[41]** The badges of trade test or criteria was first applied in the case of *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 in distinguishing between capital and revenue receipt. This was how Sharma J in that case put it:

> The following criteria for distinguishing between taxable and nontaxable selling profits are useful in determining the question:
>
> *(1) Subject matter of the transaction*
>
> *Property which does not yield income or personal enjoyment to its owner merely by virtue of its ownership, and which is normally the subject of trading and rarely the subject of investments, is more likely to have been acquired for the purpose of resale at a profit than property which does yield such income or enjoyment*;
>
> *(2) Period of ownership*
>
> *The fact that property is held for hut a short time after its acquisition may tend to indicate that the purpose of acquisition was resale at a profit*;
>
> *(3) Frequency of transactions*
>
> *If there had been a number of transactions in the same kind of property it may be presumed that the taxpayer's purpose in purchasing the particular property was its resale at a profit*;
>
> *(4) Alteration of property to render it more saleable*
>
> *The fact that material alterations or improvements have been made to property or that its character or quality has been changed so as to render it more merchantable would tend to indicate that the property was derived from a profit-making undertaking or scheme. However, if the property was clearly acquired for other purposes, extensive activities to render it more saleable after it is no longer useful for such original purposes would not cause any selling profit to be taxable*;
>
> *(5) Methods employed in disposing of property*
>
> *If special exertion is made to find or attract purchasers such as the opening of an office or advertising extensively, such facts tend to indicate the presence of a profit-making undertaking. However, such facts would not of themselves cause the profit to be taxable if the original purpose in acquiring the property was to use it rather than to resell it at a profit*;
>
> *(6) Circumstances responsible for sale*

*If sale of property is occasioned by sudden emergency or unanticipated need for funds, such facts will tend to indicate that the property was not acquired for the purpose of resale at a profit and that the sale was not pursuant to a profit-making undertaking or scheme*. (Emphasis added.)

**[42]** The High Court in *Beverly Tower Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [2022] MLJU 1873 also followed the badges of trade test to distinguish between capital and revenue disposal as evident from the following:

[90] The Malaysian courts have laid down various guidelines or test determining whether gains or profits from a transaction arises from the disposal of an investment or constitutes gains or profits from trade or adventure or concern in the nature of trade. *The acid test is known as the 'badges of trade'*, which is listed down as follows:

(i) Motive/intention of the taxpayer;

(ii) Formation of a company;

(iii) Subject matter of transactions;

(iv) Period of ownership;

(v) Frequency of transaction;

(vi) Alterations to the property;

(vii) Circumstances responsible for the realization;

(viii) Methods employed in disposing the property; and

(ix) Accounting evidence. (Emphasis added)

**[43]** *Halsbury's Laws of Malaysia*, Revenue (Vol 19, 2023) has also recognised the badges of trade as the test to distinguish between capital (investment) and income (trade) receipt as follows:

[480.038] BADGES OF TRADE

The courts have identified certain common characteristics of trade, although the word 'trade' does not lend itself readily to a definition.

The intention to trade in an asset at the time of purchasing the asset is an important element in determining whether the transaction falls within 'trade' or 'an adventure in the nature of a trade', or outside the ambit of both concepts. The intention must have existed at the time of the acquisition of the asset. The question to pose in any analysis is therefore, whether the asset was acquired with the intention of disposing it at a profit, or whether it was acquired as a permanent investment (...)

Closely related to 'intention' is the question of the profit-seeking motive of a taxpayer (...)

The method of financing a particular transaction is another factor to be considered whether that transaction is an adventure in the nature of a trade (...)

A

> If a frequency of transactions can be established, it may be submitted that while each transaction by itself may not be indicative of trading, taken together the transactions may establish a pattern indicative of trading (...)
>
> Where the subject matter lends itself to commercial transactions, the subject matter itself may be indicative of 'trading' (...)

B

> It is also imperative to examine the circumstances leading to the sale; whether the sale was prompted by the fear of government acquisition, or by the lack of capital to work the asset, or, the taxpayer was migrating and therefore had to realise his assets.

C *Does the badges of trade test apply only to acquisition of property?*

**[44]** The respondent adopted the position that the badges of trade test is inapplicable to this case as it involves a disposal of IP rights and not one involving acquisition of land.

D

**[45]** The respondent took the position that the proper test to be applied is the 'outright sale' test.

E **[46]** The appellant on the other hand, had submitted authorities to show otherwise.

**[47]** The following cases cited by the appellant were as follows:

F

(a) land (*Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn Bhd and another appeal* [2006] 3 MLJ 597);

(b) timber (*Sekong Rubber Co Ltd v Director-General of Inland Revenue* [1980] 2 MLJ 198);

G

(c) shares (*Director-General of Inland Revenue v Hypergrowth Sdn Bhd* [2008] 1 MLJ 417);

(d) cotton (*Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14);

(e) railway wagons (*Beynon & Co Ltd v Ogg (Surveyor of Taxes)* (1918) 7 TC 125);

H

(f) aeroplane linen (*Martin v Lowry (Inspector of Taxes)* [1927] AC 312);

(g) toilet roll (*Rutledge v IRC* (1929) SC 379); and

(h) whisky (*Inland Revenue v Fraser* 1942 SC 493).

I

**[48]** By contrast, the respondent's submitted no or no credible authority to support their submission that the applicable test is the 'outright sale' test.

**[49]** A consideration of the authorities cited above however makes it clear that the badges of trade test is not merely confined to the receipt or disposal of land or property.

**[50]** After a consideration of the submission and the authorities cited, we find that the badges of trade test is the proper test to be applied in this case.

Is the badges of trade test only applicable to determine whether sub-s 4(a) of the ITA is applicable?

**[51]** The respondent further submitted that the badges of trade test is also misconceived as it is only used to determine whether sub-s 4(a) of the ITA is applicable.

**[52]** Section 4 of the ITA lists the classes of income which are chargeable under the ITA as follows:

> Section 4: Classes of income on which tax is chargeable Subject to this Act, the income upon which tax is chargeable under this Act is income in respect of —
>
> (a) gains or profits from a business, for whatever period of time carried on;
>
> (b) gains or profits from an employment;
>
> (c) dividends, interest or discounts;
>
> (d) rents, royalties or premium;
>
> (e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs;
>
> (f) gains or profits not falling under any of the foregoing paragraphs.

**[53]** The respondent took the position that since the assessment in this case was raised under the 'catch-all provision' of sub-s 4(f) of the ITA instead, the badges of trade criterion has no application.

**[54]** The appellant retorted however that the reliance by the respondent on the catch all provision is wrong in law by citing the House of Lords decision of *Jones v Leeming* [1930] All ER Rep 584 the material portions of which read as follows:

> The limitations of the words 'profits and gains' were pointed out by Lord Blackburn long ago in *A-G v Black* (1871) LR 6 Exch 308 when he said that *profits and gains in Case VI must mean profits and gains ejusdem generis with the profits and gains specified in the preceding five cases*. And then there came the memorable and often quoted words of Lord Macnaghten in *LCC v A-G (9)* [1901] AC 26 when he begged to remind people 'that *income tax was a tax on income*'. *The only question, therefore, here was — was there in any sense income*? (Emphasis added.)

**[55]** The appellant also cited the cases of *InQpharm v KPHDN* (W-01 (A)-151–03/2021) and the Singapore Court of Appeal case of *Comptroller of Income Tax v BBO* [2014] 2 SLR 609 in dealing with an equivalent provision in Malaysia which took a similar view as *Jones v Leeming*.

**[56]** It can therefore be seen that the emphasis is on income generated profit. The 'catch-all provision' did not mean that anything that is a profit or gain falls to be taxed.

**[57]** Indeed, as submitted by learned counsel for the appellant, in order to apply the principle in the case of *Californian Copper Syndicate (Limited and reduced) v Harris (Surveyor of Taxes)* (1904) 5 TC 159, which has been accepted by our courts, the transaction must be viewed in light of the nature of the taxpayer's business.

**[58]** The material portions of the judgement in the *Californian Copper Syndicate* case is as follows:

> But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, *where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business*.
>
> ...
>
> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being — *Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?* (Emphasis added.)

**[59]** The operative words of the Act and the section in question here deals with tax on 'income' and it cannot be lumped into an all or sundry provision as suggested by the respondent.

**[60]** Both the SCIT and the HC had therefore erred in holding that the badges of trade test was inapplicable here.

Application of the badges of trade test

**[61]** Applying the badges of trade test to the circumstances of the case, it was evident that the receipt from the sale was not income in nature as the appellant was not in the business of selling intellectual property rights, but of manufacturing testing devices for electronic appliances pursuant to its pioneer certificate for manufacturing.

**[62]** Put another way, in the context of the badges of trade test, the sale of IP rights was not the dominant purpose of the transaction. **A**

**[63]** The IP rights were not the appellant's stock in trade but was a capital asset used in the production of the products sold by the appellant when it previously acted as an exclusive manufacturer. **B**

**[64]** It is also significant that the appellant had held and developed the IP rights for nine years before its disposal thus indicating some length of ownership. **C**

**[65]** The sale in this case was thus a one-off transaction as there was no other sale of know-how. It did not, in the context of the badges of trade test, display frequency of transaction. **D**

**[66]** The circumstances of the sale of the IP rights was also carried out pursuant to a corporate restructuring exercise to fit its new business model as a contract manufacturer and not as a profit-making exercise.

**[67]** There were also no special efforts made to attract purchasers in the form of advertisements thus clearly indicating that the sale was solely done pursuant to an internal corporate restructuring exercise. **E**

**[68]** The IP rights were sold on an as-is basis and no alterations were done to increase its merchantability. **F**

**[69]** The IP rights is intangible property that the appellant owns and uses in its operations to generate income, in manufacturing its products for sale.

**[70]** This was evident from the fact that the appellant was accorded only licensee rights which was necessary to the manufacturing of the products. **G**

**[71]** There is also merit to the appellant's submission that given the nature of the IP rights in question, there was no legal title to divest or transfer unlike rights in nature of patents. **H**

**[72]** There was to the contrary, no merit to the respondent's argument that the receipt from the disposal of the IP rights constituted 'compensation for loss of income' as it was evident from the correct application of the badges of trade test that the receipt was a sum received from the disposal of a capital asset. **I**

**[73]** The application of the badges of trade test clearly therefore indicated that the disposal of the IP rights was a disposal of a capital asset and the receipt

A from the sale of such capital asset constituted a capital receipt, which was not income in nature and therefore not taxable.

No proof of outright sale of IP rights

B **[74]** The respondent also contended that there was no proof of an outright sale of the IP rights because the IP transfer agreement and the manufacturing services agreement did not show any evidence that legal rights (title) had been transferred to ATI and ATIS.

C **[75]** This argument by the respondent does not hold water because it is not borne out by the operative clauses in the respective agreements.

**[76]** The IP transfer agreement dated 1 March 2008 sets out the intention of D parties for the appellant ('assignor') to sell, transfer and assign all of the beneficial rights in and to the IP rights to ATIS ('assignee').

**[77]** Recital B states that the assignor desires to sell, transfer and assign all beneficial rights in and to the technology to the assignee.

E **[78]** The technology refers to the IP rights and defined in the IP transfer agreement as all rights of the appellant (assignor) in or to any intellectual property which primarily consists of protected or unprotected know-how.

F **[79]** Section 1 of the intellectual property transfer agreement provides that the beneficial rights in the IP rights have been transferred from the appellant to ATIS in exchange for consideration.

G **[80]** After the sale and as evidenced by section 2.2 of the manufacturing services agreement, ATIS had licensed the IP rights to the appellant for the sole and exclusive purpose of performing the contract manufacturing services for ATIS.

H **[81]** Section 7.1 of the manufacturing services agreement also provide that ATIS (the company) is the licensor and owner of all rights in and all of the IP rights, and that the appellant (contractor) shall acquire no rights whatsoever in or to any of the IP rights.

I **[82]** Section 7.2 of the manufacturing services agreement further provides that any improvements and modifications to the IP rights may be used by the appellant (contractor) to perform the contract manufacturing services, but they will constitute the property of ATIS (the company).

**[83]** The relevant clauses and sections referred to in the IP transfer agreement and the manufacturing services agreement above therefore conclusively showed that there had been an actual sale of the IP rights to ATIS in exchange for consideration. A

**[84]** It is also pertinent to note, as pointed out by learned counsel for the appellant, that both the High Court and SCIT did not make any factual finding that there was no sale of the IP rights. B

**[85]** Learned counsel for the appellant further submitted that the HC and the SCIT's ruling that there must be a transfer of legal rights to evidence ownership of the IP rights had misunderstood the nature and concept of ownership of intellectual property rights. C

**[86]** The appellant's submitted that technical know-how represents the processes that was developed over the years to manufacture the products which helped the appellant to increase efficiency, minimise waste, damage to the products and improve the manufacturing process. D

**[87]** Technical know-how, it was contended by the appellants, has economic value because it provides a competitive advantage to its owner as the information is not generally known to or available through proper means by another person who can get economic value from its disclosure or use. E

**[88]** Intellectual property laws, they further argued, mandate that any 'legal title' to intellectual property rights exists only as to the extent they can be registered under an official registry and consequently, be afforded protection by statute. F

**[89]** Due to the confidential nature of the information, technical know-how are not registrable or patentable rights under law. This is unlike trademarks and patents. G

**[90]** It was further submitted that the key to the value of know-how is the maintenance of secrecy. To register these rights would therefore defeat the purpose of the technical knowhow, which is a company's confidential information giving competitive advantage. H

**[91]** Because of this, technical know-how is protected under the law of confidential information and contract law instead. I

**[92]** The details and particulars, it was submitted, of the invention in a patent, confidential information must be protected by ensuring that publication does not occur as this is the key to the value of know-how and to the maintenance of secrecy.

**[93]** The appellants were assisted in pursuing this contention by reliance upon the (*Overview of Know-How and Technical Assistance* (Practical Law UK Practice Note, Thompson Reuters, 2022)).

**[94]** This therefore results in the position that there is no 'legal title' under the IP rights which can be legally transferred from the appellant to ATIS.

**[95]** The appellant's find further support for their argument by relying upon an excerpt from *Intellectual Property Law in Malaysia* (Tay Pek San, Sweet & Maxwell, 2013) as follows:

> 1.3 THE LEGAL REGIME FOR THE PROTECTION OF INTELLECTUAL PROPERTY IN MALAYSIA
>
> *Most intellectual property rights in Malaysia are protected by way of statutes*. Some rights come into existence after satisfying the formal registration procedure (trademarks, patents, industrial designs, geographical indications, plant varieties) while others arise automatically when the work is created (copyright, moral rights, performers' right, layout-designs of integrated circuits) ...
>
> *Apart from these statutes, there are also non-statutory regimes which protect some forms of intellectual property*. The common law tort of passing off protects the business goodwill that is generated by a trader who uses a distinctive trade mark, get-up or other distinguishing indicia in relation to his goods or services in the course of trade. Equity plays an important role in protecting confidential information through the equitable doctrine of breach of confidence. *Such information includes* trade secrets, *technical know-how*, marital secrets or governmental secrets. *In recent years, intellectual property owners have additionally resorted to other areas of law as well, such as contract law*, and have also employed technological measures *to further strengthen the protection of their intellectual property*. This commonly takes place where the intellectual property protection of digital works is concerned. (Emphasis added.)

**[96]** Because technical know-how is not registrable under statute, the beneficial rights to the IP rights may only be transferred and protected by way of contract.

**[97]** We find ourselves in agreement with the submissions of learned counsel for the appellant in this regard.

**[98]** The IP transfer agreement was thus the contractual means and the only means under the circumstances to evidence and protect ATlSs' ownership of the IP rights after the sale.

**[99]** We therefore find the argument by the respondent that there must be a transfer of legal rights to evidence ownership of the IP rights, to be devoid of merit. **A**

**[100]** Although the SCIT and the HC held that there was no 'outright sale' of the IP rights, they did not define or make any attempt to define the meaning of the term used. **B**

**[101]** In any event, the respondent had not cited any credible legal authority, statutory or by way of case law to indicate that the proper test under the circumstances is the outright sale test. **C**

**[102]** As already determined above, the badges of trade test is the correct test to be applied in a situation like this. The contention of the respondent in this regard thus had no merit. **D**

No outright sale as the IP rights under the manufacturing agreement are not the same as the IP rights under the IP transfer agreement

**[103]** The respondent also contended that there was no outright sale because the IP rights under the manufacturing agreement are not the same as the IP rights under the IP transfer agreement. **E**

**[104]** Clause 2.1 of the IP transfer agreement stipulates that the 'legal title' shall also mean the right 'to execute license agreement and other agreements conveying rights in the technology'. **F**

**[105]** The respondent's argument on this point is premised upon the fact that as the legal title in the IP cannot be transferred by the appellant to ATIS, the latter was not given the right to execute the licence agreement and other agreements conveying rights in the IP. **G**

**[106]** The appellant's response to this was that the existence of a legal title in the first place is a prerequisite to support the argument but as there was no legal title in existence, the contention of the respondent is devoid of merit. **H**

**[107]** The wording of cl 2.1 shows that there is no legal title in and to the IP rights to be transferred from the appellant to ATIS. **I**

**[108]** The respondent also raised for the first time in argument the specific allegation that the reversion of the intangibles remain intact with the appellant.

**[109]** We however agree with the appellant that this is not borne out by the IP transfer agreement or the manufacturing services agreement.

**[110]** Nowhere do the agreements provide for the situation where the ownership of the IP rights will revert to the appellant on the happening or the non-happening of a particular event.

**[111]** Clause 1 of the IP transfer agreement on the other hand, clearly stipulate that the appellant had permanently and irrevocably sold and divested itself of the IP rights for due consideration.

**[112]** It therefore made perfect sense for the appellant to thereafter require a licence after the sale to continue utilising the IP rights in order to carry out its new role as a contract manufacturer for ATIS pursuant to cl 2.2 of the manufacturing services agreement.

**[113]** It is also pertinent to note that the said clause refers to the licence as being for the 'sole and exclusive 'purpose of performing the contract manufacturing services for the company.

**[114]** Section 7.1 of the manufacturing services agreement also provide that ATIS (the company) is the licensor and owner of all rights in and all of the IP rights, and that the appellant (contractor) shall acquire no rights whatsoever in or to any of the IP rights.

**[115]** Further to this, section 7.2 of the manufacturing services agreement states that any improvements and modifications to the IP rights may be used by the appellant (contractor) to perform the contract manufacturing services, but they will constitute the property of ATIS (the company).

**[116]** The respondent's witness also admitted that the appellant did not retain any form of retention of the IP rights after the sale and pursuant to the IP agreement.

**[117]** There was therefore no evidence, documentary or otherwise of any reversionary rights in the appellant as contended for.

**[118]** The submission of the respondent on this point was therefore misconceived and devoid of merit.

**[119]** The SCIT and the HC had therefore fallen into error when they applied the outright sale test and in then determining that there was no outright sale.

No outright sale because the receipt from the sale of the IP rights was a compensation for the loss of the appelants's future income

**[120]** The premise of the respondent's argument here rests upon the valuation methodology adopted of the IP rights in the valuation report which utilized a 'discounted cash flow 'method where the value of an asset is equal to the sum of the cash flow generated by its use.

**[121]** Both the SCIT and the HC also found that there was no outright sale of the IP rights as the receipt represented a payment for the appellant's loss of income ie drop in profit margin after its conversion to a contract manufacturer and was thus income in nature.

**[122]** The HC held that the gain received from the transfer of technical know-how related to payment for loss of income and the sum of RM821,615,000 was proven to represent the projection of future income of the appellant for the years 2008, 2009, 2010, 2011, 2012, 2013, 2014 and 2016 arising from the change of the appellant's function from full-fledged manufacturer to a contract manufacturer.

**[123]** The appellant retorted by arguing, and which we are in agreement with, that the HC and SCIT's finding that there was no 'outright sale' was inconsistent with their finding that the receipt represents payment for the appellant's loss of income.

**[124]** This is because in order for the appellant to receive a payment or a compensation for the loss of income, it must have sold the IP rights (asset) in the first place.

**[125]** Therefore, had the appellant not sold its IP rights, it would not have suffered a loss of income and would not be compensated as such.

**[126]** We are constrained to agree therefore with the appellant that the 'outright sale' test is not the proper test to be used in distinguishing between the capital or income nature of a receipt.

**[127]** We also find ourselves in agreement with the appellant that as the IP rights were utilised as a tool or apparatus or means through which the appellant performed its function as a full-fledged manufacturer, the drop in the appellant's profit margin after the change of its role to contract manufacturer proves that in fact there was an actual disposal of the IP rights as a capital asset.

**[128]** We also find ourselves persuaded by the submission by the appellant that as the appellant no longer owns the IP rights and undertakes lesser functions, risks and assets in its business operations, the appellant is only compensated by ATIS on a cost-plus basis.

**[129]** It thus stands to reason that as the appellant is only a licensee of the IP rights, the appellant was compensated on a lesser basis.

**[130]** To fortify the argument that both the SCIT and the HC had erred on this point, the evidence emanating from the trial at the SCIT showed that the methodology adopted in the valuation report was irrelevant in determining whether the gain received was capital or revenue in nature.

**[131]** In addition, the respondent's argument that the receipt is a 'compensation for loss of income based on the valuation methodology applied in the valuation report' constituted an afterthought, as submitted by learned counsel for the appellant.

**[132]** This is because at the time of issuing the assessment on 13 June 2017, the respondent had not had sight of the valuation report but proceeded to assess the receipt as an income receipt under s 4(f) of the ITA on 13 June 2017.

**[133]** The respondent was only provided with a copy of the valuation report on 19 June 2018, when the respondent had requested for the basis of valuation of the IP rights in a meeting on 1 June 2018.

**[134]** The respondent however raised for the first time in its witness statements dated 17 May 2019 at the SCIT that the receipt from the sale of IP rights was a compensation for loss of income based on the valuation methodology applied in the valuation report.

**[135]** Under all the circumstances therefore and for the reasons aforesaid, the sale of the IP rights was a disposal of a capital asset and thus not taxable as income under the ITA.

No outright sale as the appellant was still using the IP rights to manufacture the products after the said sale

**[136]** Both the SCIT and the HC failed to consider the fact that the appellant requires a license to continue using the IP rights is evidence that it no longer retains any form of ownership over the IP rights.

**[137]** In their submissions, the appellant had clearly demonstrated its position both pre and post conversion. A

**[138]** The facts show clearly that post 1 March 2008, the appellant had converted from a full-fledged manufacturer to a contract manufacturer. B

**[139]** The appellants position pre-conversion is that it functioned as a full-fledged manufacturer ie pre-1 March 2008.

**[140]** The appellant pre-conversion had manufactured and sold its own products, procured and owned the raw materials used in the manufacturing process, made its own commercial decisions, owned the IP rights used in the manufacturing process, derived profits from the selling of its manufactured goods and had assumed all the risks associated with the manufacturing process, C D

**[141]** The appellants position post-conversion as a contract manufacturer ie post 1 March 2008 was noticeably different.

**[142]** The appellant post-conversion acted as a contract manufacturer for ATIS, where the products manufactured belonged to ATIS, ATIS procures and supplies the raw materials to be used by the appellant in the manufacturing process. E

**[143]** The appellant now acts on the instructions of ATIS in respect of the contract manufacturing services and is a mere licensee of the IP rights used in manufacturing the products, as licensed by ATIS. F

**[144]** The appellant post-conversion is compensated by ATIS on a cost-plus basis and does not own the inventory, which is now owned by ATIS and where the appellant assumes little to no risks associated with the manufacturing process, which is now borne by ATIS. G

**[145]** At the risk of repetition, section 2.2 and sections 7.1 and 7.2 of the manufacturing services agreement clearly show that the appellant is a mere licensee of the IP rights after selling the same to ATIS. H

**[146]** Both the SCIT and the HC had also failed to consider the respondent's witness's admission that the fact that the appellant is licensed and requires a license to continue using the IP rights is evidence that it no longer retained any form of ownership over the IP rights. I

No invocation of anti-avoidance provisions under ss 140 or 140A of the ITA

**[147]** Another matter that militates against the argument by the respondent that there was no 'outright sale' is the fact that they had at no time seen fit to utilise the anti-avoidance provisions under ss 140 or 140A of the ITA to contend that the appellant was guilty of tax avoidance.

**[148]** These provisions in summary and in so far as relevant reads:

Section 140 of the ITA:

(a) altering the incidence of tax;

(b) relieving from a tax liability;

(c) evading or avoiding tax;

(d) hindering or preventing the operation of the ITA; or Section 140A of the ITA;

(e) the transaction ie, sale of the IP rights was not at arm's length price.

**[149]** We therefore agree with the submissions advanced by the appellant that the respondent had adopted inconsistent positions when they on the one hand, contended that the receipt from the sale of IP rights is income (instead of capital) in nature while on the other hand, contending that there was no outright sale.

**[150]** The argument of the appellant has the merit of logic when they submitted that for the appellant to receive a gain, it must have sold the asset in question ie, the IP rights, in the first place.

**[151]** In the absence of invoking the anti-avoidance provisions under ss 140 and 140A of the ITA, the respondent has no basis to now contend that there was in fact no actual sale much less contend that the receipts were income in nature.

**[152]** For the avoidance of doubt, all references in this judgement as to whether there was an 'outright sale' or not is merely by way of response to the respondent's allegation that there was no outright sale based on the circumstances. It does not alter in any way our affirmative finding that the proper test is the 'badges of trade' test and not the 'outright sale' test as contended for by the respondent.

*(B) Time bar and negligence*

**[153]** The next issue to be considered is whether the respondent's additional assessment for YA 2008 is time barred. A

**[154]** The time bar provision under s 91(1) of the ITA stipulates that the respondent may only issue an assessment within five years of the specific year of assessment (YA) and it reads: B

> The Director General, where for any year of assessment it appears to him that no or no sufficient assessment has been made on a person chargeable to tax, may in that year or within five years after its expiration make an assessment or additional assessment... C

**[155]** It is not in dispute that the five year time bar had already set in. The respondent may however, lift the time bar under certain limited circumstances as stipulated in s 91(3) of the ITA. D

**[156]** Section 91(3) of the ITA, reads:

(a) The Director General where it appears to him that — any form of fraud or wilful default has been committed by or on behalf of any person; or

(b) any person has been negligent, in connection with or in relation to tax, may at any time make an assessment in respect of that person for any year of assessment for the purpose of making good any loss of tax attributable to the fraud, wilful default or negligence in question. E

**[157]** The respondent had seen fit to lift the time bar by alleging negligence on the part of the appellant. F

**[158]** The respondent's allegations in contending that there was negligence on the part of the appellant to justify a lifting of the time bar under s 91(3) of the ITA, is threefold, namely: G

(a) allegedly failing to support its claim that the transfer of the IP rights is an outright sale;

(b) allegedly failing to provide the Valuation Report pertaining to the valuation of the IP rights during the audit stage; and H

(c) declaring the receipt from the sale of IP rights in its Income tax return form for YA 2008 as 'other income' under business source 1 — manufacturing business.

I

**[159]** The burden in proving that the appellant was negligent and so justified the respondent in lifting the time-bar rests with the respondent. See s 91(3) of the ITA and the case of *Chong Woo Yit v Government of Malaysia* [1989] 1 MLJ 473.

No outright sale

**[160]** The question as to whether there was in fact an outright sale has already been dealt with above and does not bear repetition save to stress again that we find that there in fact was an actual sale for the reasons given.

**[161]** The SCIT and the HC had therefore erred in finding that the failure to prove an outright sale of the IP rights amounted to negligent conduct.

Failure to furnish valuation report

**[162]** In respect of the allegation of negligence based upon the failure to furnish the valuation report during the audit process, it is pertinent to have regard to the chronology of events in relation thereto.

**[163]** In its letter dated 6 April 2017, the respondent enquired how the IP rights were valued in the appellant's fixed asset accounts.

**[164]** In its letter dated 26 April 2017, the appellant responded that the IP rights were not recorded as separate fixed assets in its accounts.

**[165]** It was pursuant to a meeting held on 1 June 2018 and one year after the assessment was raised on 13 June 2017, that the respondent requested for the valuation report which was duly furnished by the appellants to the respondent through its letter of 19 June 2018.

**[166]** At no time did the respondent request for the valuation report during the audit phase. There was therefore no failure to produce the valuation report as alleged.

**[167]** The appellant cannot therefore be said to have been negligent within the meaning of s 91(3) of the ITA.

**[168]** It is also pertinent that the respondent's witness RW1 testified that the production or non-production of the valuation report had no bearing on the decision made to treat the receipt of the sale of the IP rights as taxable by the respondent on 9 March 2017.

**[169]** In this respect s 91(3) of the ITA bears repetition in its entirety as follows:

> *The Director General where it appears to him that … any person has been negligent in connection with or in relation to tax, may at any time make an assessment* in respect of that person for any year of assessment *for the purpose of making good any loss of tax*

*attributable to the* fraud, wilful default or *negligence* in question. (Emphasis added.)

**[170]** It is clear from the wording of the section that the fraud, wilful default, or negligent act complained of must be attributable to the loss of tax in question to the respondent.

**[171]** Since it would not have altered the respondent's decision to bring the receipt from the sale of IP rights to tax, we do not see how the non-production of the valuation report can be said to be attributable to any loss of tax to the respondent and cannot therefore amount to a negligent act.

**[172]** Since the respondent did not raise the reason for the negligence being the failure to produce the valuation report at the time of issuing the time-barred assessment, they cannot now rely on it to raise it as a reason for lifting the time bar.

Declaring receipt from sale of IP rights as other income

**[173]** In respect of the allegation that in declaring the receipt from the sale of IP rights in its income tax return form for YA 2008 as 'other income' under business source 1 — manufacturing business, the appellant was negligent, it is pertinent to note the chronology of events that took place.

**[174]** In its letter dated 9 June 2017, the respondent alleged negligence on the part of the appellant under s 91(3) of the ITA as the appellant did not report the gain it received from ATIS.

**[175]** This is evident from the following excerpt:

> Taksiran cukai tambahan akan dibangkitkan mengikut peruntukan Seksyen 91(3) Akta Cukai Pendapatan 1967 atas kecuaian pihak tuan tidak melaporkan pendapatan ini ...

**[176]** Contrary to the allegation, the appellant had in fact duly reported the gain of RM821,615,000 on the sale of the IP rights in its tax returns and computations for YA 2008 as filed with the respondent.

**[177]** The appellant's employed a tax agent namely, PricewaterhouseCoopers, who had noted in the appellant's tax computation regarding the RM821,615,000 gain as follows:

> The above relates to gain on disposal of intellectual property by ATMP to ATIS. This gain is capital in nature.

A **[178]** The respondent's allegation of negligence was based entirely upon their disagreement with the appellant's tax treatment of the said sum as a capital gain in its tax returns.

B **[179]** The appellant was obviously advised by its solicitors and PricewaterhouseCoopers that the RM821,615,000 gain was a nontaxable capital gain.

C **[180]** The appellant thus had not willy nilly classified the sum received as capital without the benefit of the relevant advice from specialists in the field.

**[181]** We do not see how therefore the appellant can be said to be negligent for making a return on a tax position by relying upon professional advice.

D **[182]** See the cases of *Ketua Pengarah Hasil Dalam Negeri v Procter & Gamble (Malaysia) Sdn Bhd* [2022] MLJU 743; [2022] 1 LNS 754 and *Infra Quest Sdn Bhd lwn Ketua Pengarah Hasil Dalam Negeri* [2016] 8 MLJ 680 which took the position that the mere act of claiming a tax treatment, which the revenue disagrees with, cannot amount to negligence.

E **[183]** The appellant had classified the receipt from the sale of the IP rights as a capital gain in its income tax computations for YA 2008, which is non-taxable.

F **[184]** The appellant made disclosure of the receipt by reporting it in its income tax returns for YA 2008 under 'other income' under business source 1.

G **[185]** This was because, as the appellant submitted, in the income tax return form, there were no columns to declare capital gains. Therefore, the appellant had listed the capital gains in the 'other income' column.

H **[186]** The respondent's original allegation of negligence in its letter dated 9 June 2017 is that the appellant had failed to report the income from the sale of the IP rights, at the risk of repetition, as can be seen as follows:

> Taksiran cukai tambahan akan dibangkitkan mengikut peruntukan Seksyen 91(3) Akta Cukai Pendapatan 1967 atas kecuaian pihak tuan tidakmelaporkan pendapatan ini ...

I **[187]** It is therefore difficult to see how the appellant's act of declaring the same as 'other income' in its income tax returns for YA 2008 under the circumstances described above, to be a negligent act.

**[188]** The lifting of the time bar by the respondent therefore were under the circumstances and for the reasons given above, unjustified.

**[189]** The SCIT and the HC had therefore erred by misdirecting themselves accordingly.

*(C) Penalties*

Whether the respondent was correct in imposing penalties at the rate of 45% under s 113(2) of the Income Tax Act 1987 ('the ITA') against the appellant?

**[190]** The answer to this question has to be in the negative in light of our findings in respect of issues (A) and (B) above.

**[191]** In all the circumstances therefore, the SCIT and the HC were plainly wrong, had erred and misdirected themselves for the reasons stated.

**[192]** This thus warranted appellate intervention. In the premises we unanimously allow this appeal with costs of RM20,000 here and below.

**[193]** Any sums paid by the appellant to the respondent by way of tax imposed after the five-year bar is to be refunded to the appellant.

**[194]** For the avoidance of any doubt, we stress that this decision turns on and is confined to the specific and peculiar facts of this case alone.

**[195]** In respect of the issue of payment of interest on the amount to be refunded, we are of the unanimous view that as the matter of the award of interest is at the discretion of the court, we find that in all the circumstances of the case, this is not an appropriate case where payment of interest ought to be given.

**[196]** Amount paid by the appellant to the respondent is to be refunded without interest.

**[197]** Payment to be refunded within two months from today, failing which parties are at liberty to apply.

A *Appeal allowed.*

Reported by Ahmad Ismail

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